

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Hollingsworth Analyst: Marion Mann DeJong Bill Number: AB 2664

Related Bills: See Prior Analysis Telephone: 845-6979 Amended Date: 04/17/02 & 4/25/02

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Teacher Retention Credit/Increase Amount/Qualifying Educational Institution Refundable Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

X FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED
February 22, 2002 STILL APPLIES.

OTHER - See comments below.

SUMMARY

This bill would:

1. expand the teacher retention credit by:
increasing the amount of the credit, and
reducing the years of service requirement to provide credit to teachers with at least one year of service; and
2. create a refundable credit for taxpayers whose children attend a private school.

SUMMARY OF AMENDMENT

The April 17, 2002, amendments deleted an unnecessary provision that was being added to the teacher retention credit and made substantive changes to the private school credit being added by the bill.

The April 25, 2002, amendments made the following changes to the private school credit:

- added sunset and repeal dates,
- deleted the carryover provision, and
- added a reporting requirement.

Board Position:

<u> </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> X </u> PENDING

Legislative Director

Date

Brian Putler

5/1/02

Except for the "Technical Consideration," the discussion of the teacher retention credit in the department's analysis of the bill as introduced February 22, 2002, still applies. The "Federal/State Law," "Legislative History," and "Other States' Information" discussions of the private school credit in the department's analysis of the bill as introduced still apply. The remainder of the department's analysis of the private school credit as introduced is replaced with the analysis below. In addition, a revised "Summary of Economic Impact" is provided below. The Board position remains pending.

SUMMARY OF ECONOMIC IMPACT

This bill is estimated to impact Personal Income Tax revenue as shown in the following table.

Estimated Revenue Impact			
Years Beginning On or After January 1, 2002			
Enactment Assumed After June 30, 2002			
Fiscal Years			
(In Millions)			
Credits:	2002-03	2003-04	2004-05
Teacher Retention	-\$150	-\$115	-\$123
Private School	-\$850	-\$880	-\$940
Total Impact	-\$1,000	-\$995	-\$1,063

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

PRIVATE SCHOOL CREDIT

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2002, and before January 1, 2010.

THIS BILL

This bill would allow a credit for each child of the taxpayer enrolled in and attending a private school. The private school must be located in California and provide education for kindergarten to 12th grade, inclusive, or any part thereof. The amount of the credit per child would be determined by the taxpayer's adjusted gross income (AGI) for the taxable year as follows:

AGI for the Taxable Year	Credit per Child
less than \$30,000	\$3,500
at least \$30,000, but less than \$50,000	\$2,500
at least \$50,000, but less than \$100,000	\$1,500

To claim the credit the taxpayer must be eligible to claim the child as a dependent on his or her tax return. In addition, the child must complete during the taxable year the quarter or semester for which tuition is paid.

Only one credit for each child living in the taxpayer's household would be allowed. In the case of a married couple filing separate returns, the credit may be taken by either parent or divided equally between the parents.

If the credit amount exceeds the taxpayer's tax liability, the excess would be credited against other amounts due, and the balance refunded.

Beginning in 2004, the department would be required to report biannually to the Legislature regarding the impact of this credit.

IMPLEMENTATION CONSIDERATIONS

Adding a new refundable tax credit would have a significant impact on the department's programs and operations and require changes to forms and systems. In addition, the provisions of this credit would raise the following implementation concerns. Department staff is available to assist the author with any amendments as the bill moves through the legislative process.

- This bill would require regular annual appropriations by the Legislature to pay for the refundable portion of this credit. If sufficient funds were not appropriated to cover all of the refunds due, the department would suspend payment of the refunds until additional funds were appropriated. Interest would have to be paid to refund recipients for the period of time the refund was delayed. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs.
- It is unclear who is entitled to claim the credit in the case of divorced or separated parents where the custodial parent claims the child as a dependent, irrespective of support. In this case, both parents may be "eligible to claim the child as a dependent." In addition, the requirement that the child be "living in the taxpayer's household" could lead to disputes in the case of shared custody.
- Many individuals with \$50,000 income or less file their tax returns on Form 540A or the postcard-size Form 540 2EZ. To minimize the complexity of these returns, the only credit allowed on these forms is the nonrefundable renters' credit. The department could not add this proposed credit to the Form 540 2EZ as this form does not accommodate attached schedules due to its size. As a result, taxpayers that would normally file on Form 540 2EZ would be required to file Form 540A to claim the credit.
- An undetermined number of fraud investigators may be required by the department to verify this credit. Administrative costs of such investigators have not been determined at this time.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined at this time but are anticipated to be significant since the credit is refundable. Costs to administer the bill will be developed as the bill moves through the legislative process.

ECONOMIC IMPACT

Revenue Estimate

This provision would result in revenue losses of \$850 million for fiscal year 2002-03, \$880 million for fiscal year 2003-04, and \$940 million for fiscal year 2004-05.

Revenue Discussion

The revenue impact for this credit is dependent upon the number of students enrolled in kindergarten to 12th grade private schools with parents who have AGI less than \$100,000 and the amount of credits generated.

For tax year 2002, approximately 385,000 (the projected number of private school students with parents reporting less than \$100,000 of AGI) of the 650,000 students attending private school would generate composite average credits of \$2,125 for a projected total 2002 tax year revenue loss of approximately \$820 million.

Projected tax year impacts were then converted to fiscal year estimates to allow for the timing of changes in tax payments throughout the year by taxpayers taking advantage of the proposed credit (converted from \$820 per taxable year to \$850 per fiscal). These changes can represent reduced quarterly estimated tax payments, withholding, and smaller final payments with returns filed.

This estimate incorporates an estimated incentive effect based on this credit in computing the annual increase in the number of students attending private schools. Information obtained from the California Department of Education and the U. S. Census Bureau was used in the analysis.

ARGUMENTS/POLICY CONCERNS

The department is concerned with the possibility of fraud. The Internal Revenue Service (IRS) has experienced fraud with the refundable federal EIC and the potential for fraud exists with any refundable credit.

Credits generally are designed to encourage a behavior. This bill would allow a credit for behavior in which taxpayers may be currently engaged. For example, a taxpayer currently enrolling his or her child in a private school would receive this credit. In addition, since the credit is not tied to expenses paid, a taxpayer whose child attends private school on a scholarship could receive the credit.

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